



B-71 Cannon House Office Building
Washington, DC 20515
Representative Paul Ryan, *Ranking Republican*

REPUBLICAN CAUCUS

THE COMMITTEE ON THE BUDGET

Phone: (202)-226-7270
Fax: (202)-226-7174
James T. Bates, *Republican Staff Director*

FISCAL OVERVIEW OF THE PRESIDENT'S BUDGET FISCAL YEAR 2008

5 February 2007

SUMMARY

With revenue that outpaces spending over the next 5 years, the President's budget reaches balance by 2012 without raising taxes.

Spending in the President's budget increases at an average of 3.1 percent per year over the next 5 years, a reduction from last year's average growth projection of 3.6 percent over the same period. The President once again calls for a near freeze in non-defense, non-homeland security discretionary spending (spending subject to annual appropriation), and proposes a combination of entitlement initiatives and reforms that would yield net savings of \$95.9 billion during 2008-12. The President's budget also fully accounts for costs of the Global War on Terrorism.

The President also, once again, calls for making the 2001 and 2003 tax relief provisions permanent, and providing modest new tax reductions. Even with these policies, the administration projects total revenue to grow an average of 5.4 percent per year. Revenue would increase from \$2.5 trillion in 2007 to \$3.3 trillion in 2012, or from 18.5 percent of gross domestic product [GDP] to 18.6 percent.

The President's Budget: Total Spending, Revenue, and Deficits (dollars in billions)

	2007	2008	2009	2010	2011	2012	Annual Percent Change	
							2007-08	5-year annl.avg
Outlays	2,784	2,902	2,985	3,049	3,157	3,246	4.2	3.1
Revenue	2,540	2,662	2,798	2,955	3,104	3,307	4.8	5.4
Surplus/Deficit (-)	-244	-239	-187	-94	-54	61	2.1	175.5
Surplus/Deficit as % of GDP	-1.8	-1.6	-1.2	-0.6	-0.3	0.3		

Source: Office of Management and Budget.

The combination of these fiscal policies eliminates the deficit and produces a \$61-billion surplus in 2012.

For fiscal year 2007, the current fiscal year, the budget submission estimates a deficit of \$244 billion (including the supplemental appropriations request for military operations in Iraq and Afghanistan that was submitted with the budget). This is a substantial drop from last year's projected deficit for 2007 of \$354 billion. Under the President's policies, the Office of Management and Budget [OMB] estimates the deficit will decline to \$239 billion, or 1.6 percent of GDP, in fiscal year 2008, and then will shrink dramatically until disappearing in 2012. The 2008 budget deficit forecast of 1.6 percent of GDP is the lowest the deficit has been in the past 5 years and ranks eighth as a share of the economy over the past 25 years.

ANNUAL APPROPRIATIONS (Discretionary Spending)

The President requests new discretionary budget authority [BA] totaling \$929.8 billion for fiscal year 2008, an increase of 6.5 percent over the \$872.8 billion that was passed by the House for fiscal year 2007 non-emergency appropriations, and 6.8 percent above the President's 2007 request. (Because the 2007 levels are not final, the President's budget extrapolates from the continuing resolution currently in place – H.J. Res 102 – which provides funding for the government through 15 February. This discussion uses the President's numbers for comparison with 2007, with the understanding that these figures are subject to change by H.J. Res. 20, the omnibus appropriations measure recently passed by the House and awaiting action in the Senate.)

The President's Budget: Discretionary Totals (dollars in billions)

	2007	2008	Annual Dollar Change	Annual Percent Change
Regular Budget Authority:				
Department of Defense - Military	435.5	481.4	45.9	10.5
Homeland Security (nondefense)	34.1	36.4	2.3	6.7
Other Nonsecurity	<u>403.2</u>	<u>412</u>	<u>8.8</u>	<u>2.2</u>
Subtotal - Regular Appropriations	872.8	929.8	57	6.5
Emergency Supplemental Budget Authority:				
Enacted FY2007 Supplemental	72.0			
Anticipated FY2007 and FY2008 Supplemental	<u>103.0</u>	<u>145.2</u>		
Subtotal - Supplemental and Emergency	175.0	145.2		
Total	1,047.8	1,075	27.2	2.6

Source: Office of Management and Budget
Figures may not add due to rounding.

The budget continues the President's trend of shifting funding toward his priorities – namely defense and homeland security. The 6.5-percent increase in discretionary spending over the likely 2007 level can be attributed largely to a 10.5-percent increase in defense spending and an 6.7-percent increase in homeland security spending.

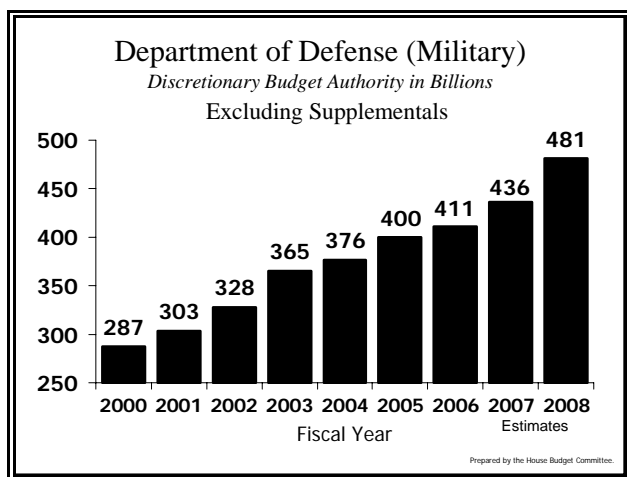
Non-security discretionary spending is projected to increase by 2.2 percent from 2007 to 2008. But over the 5 years covered by the budget submission (2008-12), the administration assumes an annual average growth rate that declines by 1 percent for programs and activities in this category.

This negative growth rate is well below the projected rate of consumer price inflation, and a sharp reduction from the 2.2-percent average rate of increase in the preceding 5-year period.

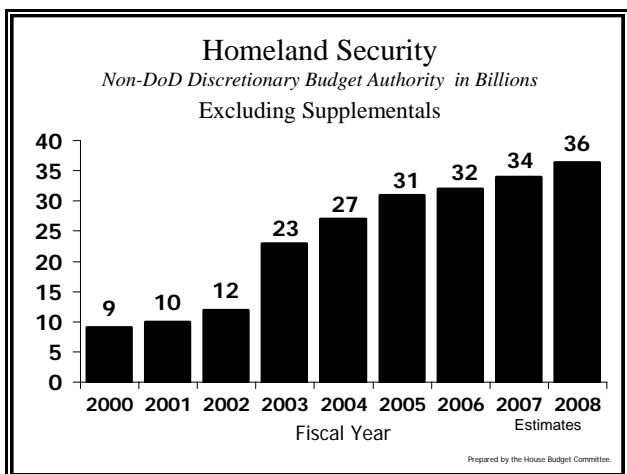
In addition to the regular discretionary proposal, the President requests emergency supplemental appropriations of \$103 billion in fiscal year 2007 and projects emergency supplementals of \$145 billion in 2008, and \$50 billion in 2009. Of the \$103 billion requested in 2007, \$99.6 billion is for ongoing operations in Iraq and Afghanistan, and \$3.4 billion is for hurricane-recovery activities. These funds are in addition to the \$70 billion in emergency funding already appropriated in 2007. The \$145 billion for 2008 emergency funding and the \$50 billion for 2009 emergency funding is entirely for the Global War on Terrorism. The 2009 figure is strictly a placeholder to ensure that outlays for the war are considered in deficit projections. The growth rate in discretionary spending between 2007 and 2008 including emergency spending is forecast at 2.6 percent.

A further look at these three individual categories follows:

- **Defense Appropriations.** The administration recommends \$481.4 billion in BA for fiscal year 2008 for the military functions of the Department of Defense, an increase of 10.5 percent over the \$435.5 billion for fiscal year 2007. This continues the growth trend in recent years for this category, though at a significantly faster rate than the 6.2-percent average annual growth of 2001-07 (see chart).

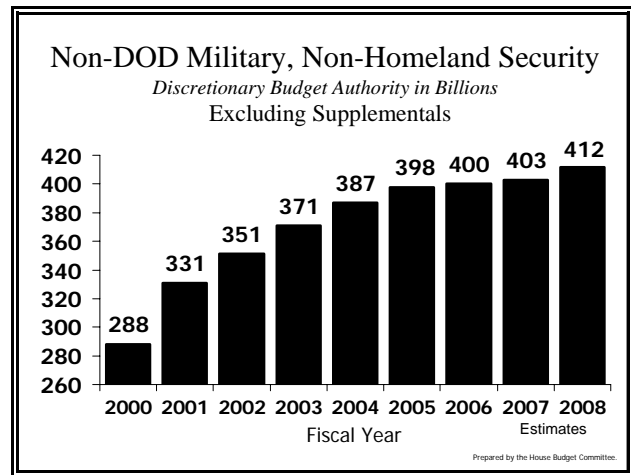


- **Homeland Security Appropriations.** The administration recommends \$36.4 billion in fiscal year 2008 for non-defense homeland security – an increase of \$2.3 billion, or 6.7 percent, over the \$34.1 billion in fiscal year 2007. Prior to 11 September 2001, spending for homeland security was about \$9 billion. Since then, this category has grown at an average annual rate of 22.6 percent. The President's requested increase for fiscal year 2008 reduces this rate of growth, but is still more than twice the inflation rate.



The Department of Homeland Security [DHS] will increase from \$32 billion in 2007 to \$34.3 billion in 2008 under the President’s request. This \$2.3-billion increase is a 7.2-percent year-over-year increase for this agency. (This does not reflect discretionary spending outside DHS or mandatory spending within the Department.)

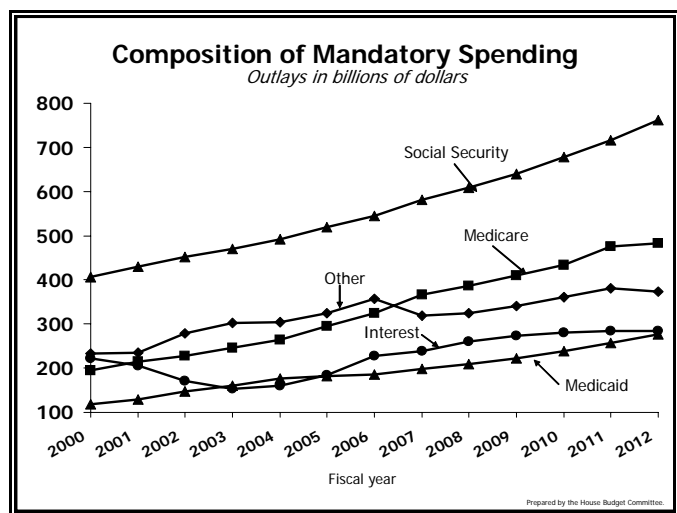
- **All Other Appropriations.** The administration recommends \$412 billion in fiscal year 2008 for appropriated spending other than defense and Homeland Security – an increase of nearly \$9 billion, or 2.2 percent, above the level for fiscal year 2007 (see chart). For years after 2008, as noted above, the budget assumes a slight reduction on this portion of discretionary spending from the 2008 level. It is primarily through this spending restraint, combined with the mandatory proposals described below, that the President is able to balance the budget in 2012.



ENTITLEMENT INITIATIVES AND REFORMS (Mandatory Spending)

Mandatory spending in the President’s budget would reach \$1.456 trillion in fiscal year 2007, somewhat lower than the OMB “baseline” – which reflects amounts that would occur under current laws and policies without change – and \$1.527 trillion in fiscal year 2008, roughly \$10.5 billion lower than the OMB baseline level. The proposed 2008 spending is roughly 4.2 percent above the 2007 baseline level of \$1.465 trillion for fiscal year 2007. Total mandatory spending continues to increase each following year at an average annual rate of 5.6 percent, reaching \$1.922 trillion in fiscal year 2012.

The net effect of the administration’s proposals is to moderate the rate of growth in total mandatory spending. This results in net savings – measured against the baseline as described above – of \$90 million in fiscal year 2007, \$9.7 billion in fiscal year 2008, and \$95.9 billion for fiscal years 2008-12. These savings grow to \$309.3 billion for 2008-17. The savings during 2008-12 are caused



primarily by the President's Medicare proposals, which would save an estimated \$65.6 billion over the 5-year period.

Several administration savings proposals are repeated from the fiscal year 2007 request. These include: increasing sales of the National Defense Strategic Minerals Stockpile; increasing Pension Benefit Guaranty Corporation [PBGC] premiums; reforming child tax and earned income tax credits; reducing agriculture commodity programs; imposing Environmental Protection Agency [EPA] fees; recovering unemployment insurance benefit overpayments; and imposing spectrum license fees. In addition to those recurring proposals, the administration proposes substantial savings from Medicare.

The President's Budget: Net of Mandatory Proposals

(dollars in billions)

	2007	2008	2009	2010	2011	2012	2007-12	2008-17
Total Mandatory Proposals	-0.1	-9.7	-17.4	-18.8	-23.1	-26.9	-96.0	-309.3

Source: Office of Management and Budget.

Initiatives

The largest mandatory spending initiative in the President's budget is for the Social Security personal accounts. This proposal would allow workers to invest some of their payroll taxes into personal retirement accounts for their use upon retirement, which increases spending. When those workers begin to draw on their personal accounts as a supplement to Social Security, spending will be commensurately reduced, so this increase in spending occurs only during the transition to a retirement system in which personal accounts are a basic component of retirement security. This cost begins in fiscal year 2012, and outlays associated with the provision increase spending by \$637.4 billion between 2012 and 2017.

The President's Budget: Major Entitlement Initiatives

(dollars in millions)

	2007	2008	2009	2010	2011	2012	2008-12	2008-17
Soc. Security Personal Accounts	0.0	0.0	0.0	0.0	0.0	29,348	29,348	637,441
Increase Pell Grants	0.0	532	2,375	3,256	4,133	5,039	15,335	43,058
Medicaid/SCHIP	0.0	710	1,095	620	890	845	4,160	9,680
Farm Bill	0.0	500	500	500	500	500	2,500	5,000
TANF	0.0	0.0	240	296	309	326	1,171	2,768

Source: Office of Management and Budget.

The second largest initiative calls for an increase in the Pell Grant maximum award from \$4,050 to \$5,400. This program is expected to phase in over 5 years.

Reforms

Medicare savings provide the largest 5-year savings. The reduced growth in Medicare spending would produce savings of \$4.7 billion for fiscal year 2008, \$66 billion for fiscal years 2008-12, and \$252.5 billion for 2008-17. Nevertheless, net Medicare outlays continue to grow at an average of 5.6 percent per year. The next largest savings proposal is a reduction in lender subsidy payments by 50 basis points for student loans. This will create savings of \$688 million in 2008, \$11.2 billion over 5 years, and \$29.5 billion over 10 years. Likewise, Medicaid reforms provide a savings of \$29 billion over a 10-year period; still, total Federal spending for Medicaid and the related State Children's Health Insurance Program [SCHIP] continues growing at about 7 percent per year. A proposal to recall Federal Perkins Loans revolving funds results in a savings of \$419 million in 2008, \$3.2 billion over 5 years, and \$6.4 billion over 10 years.

The President's Budget: Major Entitlement Reforms (dollars in millions)

	2007	2008	2009	2010	2011	2012	2008-12	2008-17
Medicare	0.0	-4,696	-9,113	-13,077	-17,463	-21,695	-66,044	-252,432
Reduce Lender Subsidy Payments for Student Aid	0.0	-688	-2,165	-2,558	-2,792	-2,986	-11,189	-29,494
Medicaid/SCHIP Reforms	0.0	-1,925	-2,170	-2,385	-2,680	-2,850	-12,010	-29,090
Reform PBGC	0.0	0.0	-1,390	-1,387	-1,400	-1,295	-5,472	-10,569
Recall Perkins Loan Funds	0.0	-419	-498	-713	-814	-779	-3,223	-6,358
ANWR	0.0	0.0	-3,502	-2	-503	-3	-4,010	-4,025
UI Integrity	0.0	0.0	-484	-494	-351	-355	-1,684	-3,619

Source: Office of Management and Budget.

REVENUE PROPOSALS

As noted, the President's budget projects that Federal tax revenue will grow at an average of 5.4 percent per year over the next 5 years. This rate compares with double-digit revenue growth in the past 2 years, and an 8.1-percent increase in tax revenue in the first quarter of fiscal year 2007 (October-December 2006). The projection assumes that provisions of the tax relief laws enacted in 2001 and 2003 will continue throughout the projection period, and will not expire as scheduled after 31 December 2010.

The budget proposes a number of tax and trade policy changes that affect revenue (and, to a lesser extent, outlays as well). Taking these policies into account, OMB projects that receipts will increase from \$2.540 trillion (18.5 percent of GDP) in fiscal year 2007 to \$3.307 trillion (18.6 percent of GDP) in fiscal year 2012. Over the past 40 years, the average level of Federal revenue has been 18.2 percent of GDP.

The administration's tax and trade policies have budget effects of \$9.6 billion in fiscal year 2007, \$51.5 billion in fiscal year 2008, and \$225.1 billion over 5 years; the President's new deduction

for health insurance will increase outlays by \$14.3 billion over 5 years. The administration would partially offset these budget effects by enacting a number of revenue-raising provisions that would increase revenue by \$1.6 billion in fiscal year 2008 and by \$16.7 billion over 5 years. The President also has a number of proposals that will close loopholes, curtail tax avoidance, and improve tax compliance.

The President's Budget: Receipts Proposals - Summary
(dollars in billions)

	2007	2008	2009	2010	2011	2012	Total 2008-12
Make Permanent 2001, 2003 Tax Relief ^a	0.188	-0.690	-1.595	-13.789	-146.513	-211.358	-373.945
Incentives and Tax Relief	0.061	-1.325	-32.348	-39.893	-33.528	-24.951	-132.045
Extend Expiring Provisions	-9.186	-51.266	4.089	-9.385	-10.738	-11.865	-79.165
Revenue Offsets	0.017	1.568	2.815	3.541	4.241	4.571	16.736
Other	-0.466	-0.453	-6.786	-7.245	-7.770	-8.332	-30.586
Total Receipts Effect (with permanence of 2001, 2003 provisions as additional relief)	-9.386	-52.166	-33.825	-66.771	-194.308	-251.935	-599.005
Total Receipts Effect (with permanence of 2001, 2003 provisions assumed in baseline)	-9.574	-51.476	-32.230	-52.982	-47.795	-40.577	-225.060
Total Outlay Effect ^b	---	-0.388	-0.297	4.021	3.780	17.646	24.762

Source: Office of Management and Budget.

^a The administration assumes the permanence of these provisions within the baseline, not as new legislation. This table represents the revenue effects both ways. Totals may not add due to rounding.

^b Reflects refundable portion of certain tax credit provisions, under the assumption that the permanence of 2001 and 2003 provisions are not in the baseline.

The overall set of revenue proposals, summarized in the table above, can be categorized as follows:

- **Making Permanent the 2001 and 2003 Tax Legislation.** A top administration priority is making permanent the broad tax relief provided in 2001 – generally scheduled to expire after 31 December 2010 – and most of the growth package enacted in 2003. If these tax laws were allowed to expire as scheduled, the result would be a tax increase of \$690 million in fiscal year 2008 and \$373.9 billion over 5 years. As noted, the extension of these laws is assumed in the budget's baseline, not as a new tax reduction.
- **Tax Relief Initiatives.** The administration also proposes the additional tax initiatives in several areas, including personal savings, small business, health care, charitable giving, economic development, benefits for families, and education deductions. These provisions have revenue effects totaling \$1.3 billion in 2008, and \$132.0 billion over 5 years.
- **Investing in Health.** The administration includes a number of tax-related provisions aimed at making health care more affordable, accessible, and flexible. These provisions include the expansion of Health Savings Accounts, and the health insurance deduction introduced in the State of the Union address. Taken together, the impact is \$319 million in 2008, and \$124.9 billion over 5 years.

-
-
- **Extending Expiring Tax Provisions.** The administration makes permanent or extends temporarily a number of tax provisions that expired during the current year or are scheduled to expire during the budget year. These include a 1-year extension of current alternative minimum tax [AMT] policies for individuals, and the research and experimentation tax credit. The extenders proposed by the administration have revenue effects of \$9.2 billion in 2007, \$51.3 billion in 2008, and \$79.2 billion between 2008 and 2012.
 - **Revenue Offsets.** The administration has included a number of revenue offsets in its budget, intended not only to raise revenue but also to close loopholes, curtail tax avoidance, and improve tax compliance. These provisions increase revenue by \$1.6 billion in 2008, and \$16.7 billion over 5 years.
 - **Trade Policies.** The administration also has an ambitious agenda for expanding American exporters' access to foreign markets. To this end, the administration hopes to conclude negotiations during 2007 on several free trade agreements, and to extend, through the end of calendar year 2012, the Generalized System of Preferences. These agreements have revenue effects of \$241 million in 2008, and \$3.7 billion over 5 years.